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Supreme Court of the United States

OCTOBER TERM 1940

No. 1048 84

SARGENT & COMPANY, a corporation, BAXTER, KELLY & FAUST, INC., a corporation, M. B. FITZGIBBON, doing business under the firm name and style of M. B. FITZGIBBON CO., and ANNA LOUISE LINAHAN,

Petitioners,

against

AGATHA L. MOORE, BASIL MOORE, MARGARET WIKSTROM, VINCENT JOYCE and M. HAROLD HIGGINS, and J. P. LINAHAN, INC., debtor in proceedings to reorganize a corporation under the National Bankruptcy Act,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

RAYMOND J. SCULLY,
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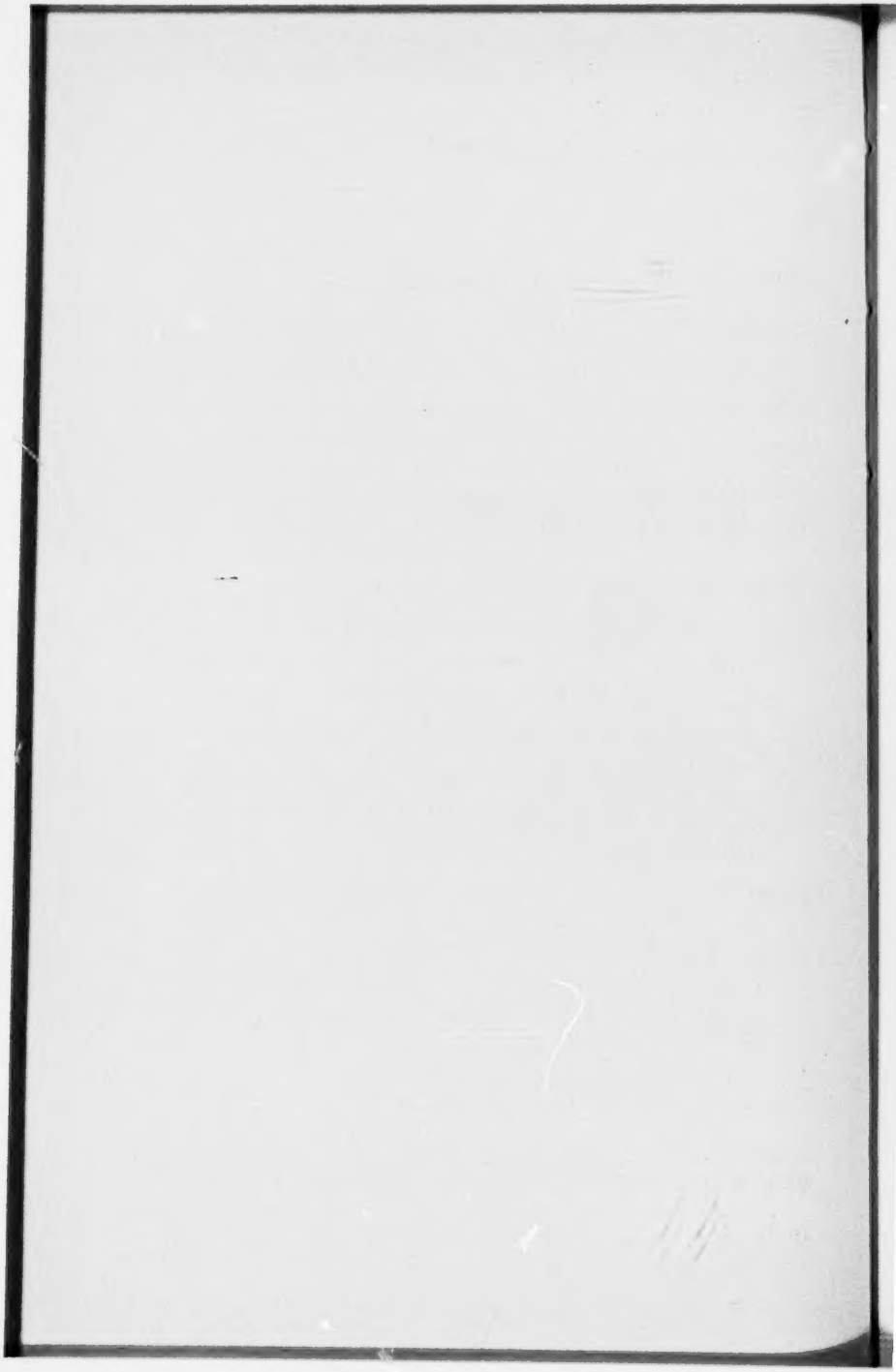
HILBERT I. TRACHMAN,
Counsel for Petitioner, Anna L. Linahan.

Press of Fremont Payne, Inc.



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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

TO THE HONORABLE THE CHIEF JUSTICE AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioners respectfully show as follows:

Statement

This is an application for a writ of certiorari to review a decree of the United States Circuit Court of Appeals for the Second Circuit, entered on February 14, 1941 (Tr. 725) insofar as that decree reverses the order and judgment made on May 18, 1940, by Honorable Alfred C. Coxe,

United States District Judge for the Southern District of N. Y. (Tr. 65 et seq.) and grants leave to the debtor, through a new board of directors, to withdraw its consent to reorganization by filing a new Answer. The said order and judgment of Honorable Alfred C. Coxe (Tr. 65-67) approved the Findings of Fact and Conclusions of Law and the Report of the Special Master of April 26, 1940 (Tr. 68-89), and approved the petition of the creditors together with the written consent of the debtor as having been properly filed under Chapter X of the Bankruptcy Act.

Opinions Below

The opinion of the Circuit Court sought to be reviewed, dated January 27, 1941, is reported in 117 Fed. (2d) 140 and is printed in full on pages 718 to 724 of the transcript of record herein.

Basis for Jurisdiction

The jurisdiction of this Court is invoked under Section 240-A of the Judicial Code as amended by the Act of February 13, 1925 (43 Stat. 938; 28 U. S. C. A. Sec. 347(a)).

Questions Involved

I. May a debtor which has invoked the jurisdiction of the Federal Court by filing, prior to approval of an involuntary petition, a written admission of its inability to meet its debts as they mature, a consent to reorganization under Chapter X, and a request for approval of the Chapter X petition, defeat such jurisdiction by withdrawing such consent under the guise of filing an amended answer, although it appears after trial that the debtor requires reorganization under Chapter X?

II. Do the provisions of Sections 126 and 142 of Chapter X of the Bankruptcy Act prohibit a debtor from expediting the proceeding by consenting to reorganization and requesting the approval of an involuntary petition?

III. Does the creditors' petition in conjunction with the debtor's written admission of its inability to meet its debts as they mature, its consent to reorganization under Chapter X, and its request for approval of the Chapter X petition, satisfy the requirements of Secs. 130 and 131 of the Bankruptcy Act?

IV. Was the Circuit Court required by Rule 15(a) of the Federal Rules of Civil Procedure to permit the debtor to withdraw as a matter of right its written consent to reorganization under Chapter X and its request for approval of the Chapter X petition upon the basis of which the District Court had assumed jurisdiction?

V. Do the directors of a corporation in financial distress require the approval of the majority stockholders in order to consent to the jurisdiction of a court for a reorganization proceeding?

Summary Statement

This is a proceeding for the reorganization of J. P. Linahan, Inc., the debtor, under Chapter X of the Bankruptcy Act, instituted by the filing of a creditors' petition on February 20, 1940. The debtor and minority stockholders consented to the creditors' petition. The majority stockholders contested it. After a trial before a Special Master the petition was approved as properly filed under Chapter X. All claims against the estate of the debtor have been filed, and proposed plans of reorganization have been submitted by both sides to this controversy.

It should be stated at the outset that this is not a case where any party is resisting the reorganization of the debtor. All parties agreed: (a) that the debtor is unable to meet its debts as they mature; and (b) that the affairs of the debtor require reorganization under the Chandler Act.

The fundamental controversy in the District Court and in the Circuit Court has been whether the reorganization shall proceed under Chapter X or Chapter XI. The Special Master has found that adequate relief could not be obtained under Chapter XI and that the proceeding should continue under Chapter X (Tr. 82, 85, 86). This finding was confirmed by the District Court (Tr. 65-67) and has not been disturbed by the Circuit Court (Tr. 724).

The Circuit Court, sacrificing substance for form (Tr. 724), almost one year after the filing and approval of the petition, reversed the decree of the District Court approving it, on the ground that the debtor's consent and prayer for the approval of the creditors' petition could not convert the proceeding into a voluntary one and that therefore it was necessary for the creditors to prove the commission of an act of bankruptcy by the debtor. It also permitted the debtor through a new board of directors selected by the majority stockholders, to file a new answer which would withdraw its consent and which would place in issue the commission of an act of bankruptcy. The Circuit Court ruling turned primarily upon literal constructions of several Sections of Chapter X which it erroneously interpreted in violation of the intent of the Act and in disregard of the functional aspects and practical administration of the Act.

The pertinent facts in chronological order are as follows:

J. P. Linahan, Inc., hereinafter referred to as the "debtor", for sixteen years has been engaged in the manufacture and sale of caskets and funeral supplies in the City of New York. At the commencement of the proceeding

its book assets were $416,198.76 and its liabilities $233,-909.24 (Tr. 13), 2,951 shares of its stock were outstanding: 1,800 owned by Agatha L. Moore and her designees, referred to throughout as "majority stockholders"; 750 shares owned by Anna Louise Linahan, individually and as Executrix of the Estate of James P. Linahan, deceased (the founder of the company), referred to throughout as "minority stockholders"; and 401 shares owned by officers, directors and employees of the company (Tr. 73, 74). Neither the majority nor minority stock interests have been connected with the operation of the business. The management was confined to the directors, officers and employees, who with two exceptions have served for many years (Tr. 74-77).

Unable to pay its debts as they matured, the debtor, through its officers, held a series of conferences with the attorneys for the majority and minority stockholders and with the creditors and their attorneys, which commenced in January, 1940. The majority stockholders repeatedly represented the stock of the debtor to be worthless and offered to pay creditors 40 cents on the dollar or to take the same percentage for their own claims and to "throw in" the stock of the debtor held by them (Tr. 75, 451, 452, 457, 459, 460, 551). When this offer was rejected, the majority stockholders sought, unsuccessfully, to have the directors and officers of the debtor file a Chapter XI petition proposing a payment to creditors of 20% in full for their claims (Tr. 76, 548, 552, 553).

Although all parties recognized the need for reorganization, an agreement could not be reached and on February 14, 1940, in the presence of all parties or their attorneys, the creditors appointed a Committee and instructed counsel to file a petition under Chapter X (Tr. 500). Such a petition was filed on February 20, 1940 (Tr. 5-18). The officers of the debtor, the following day called a meeting of the board of directors of the debtor (which board had constituted the management of the debtor for many years) (Tr. 15,

78). At this meeting a resolution was unanimously adopted which declared the debtor's inability to pay its debts as they matured; its willingness to be reorganized under Chapter X; its request that the creditors' petition be immediately approved; and directing the execution and filing of an answer to the creditors' petition containing the foregoing admissions and consent (Tr. 13, 15, 16, 17). Such an answer and consent (Tr. 13-17) together with a certified copy of the resolution of the board of directors (Tr. 18 to 19) and an affidavit of Lester S. Berry (Tr. 34-37), the President of the debtor, was filed. Whereupon, Honorable Alfred C. Coxe, District Judge, assumed jurisdiction of the proceeding and made an order based specifically upon both the creditors' petition and the debtor's answer and consent, approving the petition for reorganization as properly filed under Chapter X and continuing the debtor in possession (Tr. 37).

On February 26, 1940, Agatha L. Moore, one of the majority stockholders, filed an answer as a creditor (Tr. 20-22). On March 26, 1940, the majority stockholders filed an answer on their own behalf and derivatively on behalf of the debtor (Tr. 23-31). By these answers, the majority stockholders admitted that the debtor could not pay its debts as they matured, but contended that no act of bankruptcy had been committed, that the consent of the debtor was fraudulently filed by its board of directors, and that adequate relief could be obtained under Chapter XI. On March 8, 1940, Anna Louise Linahan, one of the minority stockholders, filed an answer similar to that of the debtor and prayed for relief under the provisions of Chapter X (Tr. 31-33).

The issues raised by the pleadings were fully tried before Special Master Peter B. Olney, Jr., who decided them adversely to the majority stockholders (decision, Tr. 604-610) and recommended the approval of the creditors' petition and the debtor's answer and consent as having been properly filed under the provisions of Chapter X. His find-

ings made on April 26, 1940 (Tr. 68-89), were confirmed by the District Court (Tr. 65-67) and were not disturbed or over-ruled by the Circuit Court, except for one conclusion of law (opinion, Tr. 718 et seq.).

Amongst other findings, it was held that adequate relief could not be obtained under Chapter XI and that Chapter X was the appropriate one for this proceeding (Tr. 82, 85, 86) and that the board of directors was not guilty of fraud in filing a consent to a Chapter X proceeding (Tr. 82, 83, 84).

The District Court also held as a matter of law that by the filing of the consent of the debtor, requesting approval of the Chapter X petition the commission by the debtor of an act of bankruptcy became immaterial to the issues and that the proceeding in effect became a voluntary one. In so holding the District Court relied upon *In Re Palisades-on-the-Desplaines,* 89 Fed. 2d 214, C. C. A. 7th; *In Re Park Beach Hotel Building Corp.,* 96 Fed. 2d 886, C. C. A. 7th (cert. denied 59 Sup. Ct. 105, 305 U. S. 638 mem.); and *In Re Snyder* v. *Fenner,* 101 Fed. 2d 736, C. C. A. 3rd.

The Circuit Court for the Second Circuit expressly disagreed with the above decisions of the Seventh and Third Circuits and reversed the order of May 18, 1940, which approved the petition as properly filed under Chapter X.

The Circuit Court also granted leave to the debtor, through a new board of directors, to file a new answer and thus withdraw the consent to reorganization upon which the approval order was in part based. The facts relating thereto are as follows: The annual meeting of the stockholders of the debtor was originally fixed for a date in September, 1939, but due to the indifference of the stockholders and their failure to attend, it had been adjourned from time to time to February 14, 1940 (Exhibit 4 not printed at length; see Tr. 714) and again adjourned to February 24, 1940 (Tr. 560, 561). This meeting was thereafter adjourned to March 2, 1940. On February 28, 1940, the majority stockholders

applied to the District Court for leave to elect new directors (Tr. 705). The Special Master denied the application on March 20, 1941. On appeal, the Circuit Court reversed the order on May 6, 1940 (*In Re J. P. Linahan, Inc.*, 111 Fed. 2d 590).

On June 5, 1940, the majority stockholders' new board of directors sought leave to file a new answer on behalf of the debtor (Tr. 230-261). This application was addressed to the court's discretion and not sought as a matter of right. The proposed answer (Tr. 248-261) of the new board, although admitting the inability of the debtor to pay its debts as they mature and its need for reorganization, alleged that the action of the old board in consenting to the Chapter X proceeding was fraudulent and that adequate relief could be obtained in Chapter XI, both of which issues had already been determined otherwise by the District Court after trial of similar issues raised by the answers of the majority stockholders.

The application to file a new answer was denied by the District Court (opinion of Special Master, Tr. 282-290; order of District Court Tr. 228-229). The Circuit Court dismissed the appeal from this order as moot (Tr. 725), but granted leave to file a new answer as a matter of right. The grounds upon which the Circuit Court reached this conclusion were: that the majority stockholders should normally have their way and the board of directors should not commit the debtor to a course of conduct not approved by the majority stockholders, and that the debtor could have filed within twenty days an amended answer as a matter of right under Rule 15(a) of the Federal Rules of Civil Procedure, had not the District Court enjoined the election of a new board of directors.

On the first ground, the Circuit Court, though recognizing that directors who exercise their honest judgment are "immune from the control of their shareholders", reached a decision in conflict with the decisions of the

Court of Appeals of the State of New York and of this Court. The second ground, i. e., the filing of the answer as a matter of right, was a conclusion reached by the Circuit Court as one "impossible to avoid."

Reasons Relied on for the Allowance of the Writ

1. The Circuit Court of Appeals for the Second Circuit has decided erroneously, petitioners respectfully submit, questions of public importance which are vital to the proper administration of Chapter X of the Bankruptcy Act and which fundamentally affect the functional application of Chapter X. These questions have not been, but should be settled by this Court. The questions presented require a construction of Sections 126, 130, 131, 136, 137, 142 and 161 of Chapter X and Rule 15(a) of the Federal Rules of Civil Procedure. A decision in this case will determine the application of the Act and Rules in many other cases.

2. The decision of the Circuit Court of Appeals for the Second Circuit is in direct conflict with the decisions of the Seventh Circuit, *In Re Palisades on the Desplaines,* 89 Fed. 2d 214, and *In Re Park Beach Hotel Building Corp.,* 96 Fed. 2d 886, and with the decision of the Third Circuit, *In Re Snyder* v. *Fenner,* 101 Fed. 2d 736, and with the decision of this Court in *Securities & Exchange Commission* v. *United States Realty Improvement Co.,* 60 Sup. Ct. 1044, 1053, 310 U. S. 434, 451, 455.

3. The decision of the Circuit Court of Appeals for the Second Circuit conflicts with the decisions of this Court in *Royal Indemnity Co.* v. *American Bond & Mortgage Co.,* 289 U. S. 165, 53 Sup. Ct. 551, and the decisions of the Court of Appeals of the State of New York in *Rogers* v. *Pell,* 154 N. Y. 518, 527; *Young* v. *Stone,* 61 App. Div. 364, 70 N. Y. Supp. 558, affirmed: 174 N. Y. 517, 66 N. E. 1118,

and *Manise* v. *Powell,* 201 N. Y. 194, on the issue of the rights of majority stockholders and their control over the board of directors.

WHEREFORE, the petitioners respectfully pray that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the Circuit Court of Appeals for the Second Circuit, commanding that court to certify and to send to this Court for its review and determination on a day certain to be therein named, a transcript of the records and proceedings herein, and that the order of said court entered on February 14, 1941, reversing the judgment and decree of the District Court for the Southern District of New York of May 18, 1940, and granting the debtor leave to file a new answer, be reversed by this Honorable Court, and that petitioners have such other and further relief in the premises as to this Honorable Court may seem just and equitable.

Dated, May 3rd, 1941.

RAYMOND J. SCULLY,
Counsel for Petitioners, Sargent
& Company, *et al.*

HILBERT I. TRACHMAN,
Counsel for Petitioner,
Anna Louise Linahan.

State of New York,
City of New York,
County of New York, } ss.:

RAYMOND J. SCULLY and HILBERT I. TRACHMAN, being duly sworn, depose and say: That they are counsel for the petitioners named in the foregoing petition. That they prepared the same, and that the allegations thereof are true, as they verily believe.

RAYMOND J. SCULLY,
HILBERT I. TRACHMAN.

Subscribed and sworn to before me
this 12th day of May, 1941.

CLAIRE LESSER,
Notary Public, Bronx County,
Bronx Co. Clk's No. 36, Reg. No. 94L43.
N. Y. Co. Clk's No. 591, Reg. No. 3L367.
Commission expires Mar. 30, 1943.

CL.